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**USTR Settles Successful WTO Case Opening Japanese Market for Distilled Spirits
and Eliminating Discriminatory Taxes and Tariffs**

U.S. Trade Representative Charlene Barshefsky announced today that the United States and Japan have successfully settled their WTO dispute on Japan's taxation of distilled spirits. The settlement will eliminate tariffs on white spirits, will accelerate Japan's elimination of tariffs on brown spirits, and will ensure that U.S. exports of distilled spirits will no longer face discriminatory tax treatment in Japan.

"I welcome this settlement which resolves a long-standing dispute between the United States and Japan. Through the termination of Japan's discriminatory tax regime and elimination of tariffs on a wide range of distilled spirits, U.S. distilled spirits suppliers will have a genuine opportunity to compete in the Japanese market, the second largest market for U.S. suppliers in this sector," stated Ambassador Barshefsky. "This settlement demonstrates that WTO dispute settlement procedures work for U.S. companies and workers," she added, "and by using the leverage that WTO rules provide, we were able to get a substantially better deal for our companies than we could get in the Uruguay Round. I also want to express my appreciation to Ambassador Saito for his efforts in resolving this matter."

Under today's settlement, Japan will adjust its excise tax rates on several categories of distilled spirits in order to come into compliance with WTO rulings for whisky and shochu "A" by May 1, 1998, and for shochu "B" by October 1, 2000. Moreover, Japan has agreed to eliminate tariffs on all brown spirits (including whisky and brandy) and vodka, rum, liqueurs, and gin by April 1, 2002. These tariff cuts go well beyond those in the Uruguay Round, when Japan deferred to 2004 its elimination of tariffs on brown spirits, and blocked tariff elimination on white spirits.

Japan also agreed to provide the United States with information on any measures or subsidies for its domestic distilled spirits industry which Japan might adopt. This information will allow the United States to verify that such measures do not in any way nullify or impair the benefits provided to the United States as a result of this settlement. Japan also agreed to disclose any existing measures that may nullify or impair the benefits of the settlement.

The U.S. distilled spirits industry estimates that as a result of this settlement with Japan, excise taxes on U.S. spirits exports to Japan will be reduced nearly 60 percent, for an annual tax savings of \$94 million. Additional tariff and tax cuts will save another \$45 million. The industry's conservative estimate is that annual exports to Japan of U.S.-origin distilled spirits will increase \$20 million, an increase of over 20 percent.

This settlement represents the 33rd market-opening trade agreement reached with Japan during the Clinton Administration.

BACKGROUND

WTO Dispute Settlement Proceedings

In July 1995, the United States requested consultations with Japan concerning its liquor tax system, and the EC and Canada made similar requests for consultations. After consultations with Japan failed to produce a mutually acceptable solution, the DSB established a single dispute settlement panel for the three parties on September 27, 1995.

The U.S. complaint was that Japan's liquor tax regime unfairly favored domestic distilled spirits, i.e., *shochu* A and *shochu* B, over imported products such as bourbon whisky and vodka. For instance, the excise tax rate on whisky was four times greater than on *shochu* A, and six times greater than on *shochu* B. Similarly, the tax rate on vodka was over 1.5 times and 2.5 times greater than on *shochu* A and *shochu* B, respectively. *Shochu* A and *shochu* B are traditional clear spirits produced from grain, potatoes, sweet potatoes or molasses.

The panel ruled in favor of the complaining parties in its report, finding that Japan's liquor tax regime was inconsistent with Japan's WTO obligations. Japan then appealed the panel's findings. The Appellate Body affirmed the panel's conclusions, and on November 1, 1996, the DSB adopted both the Appellate Body report and the original panel report.

The panel and Appellate Body reports found that:

- vodka and *shochu* (types A and B) are "like products" and so must be taxed identically; the divergence in Japan's tax rates was inconsistent with Japan's WTO obligations; and
- all *shochu* and other white and brown spirits are "directly competitive or substitutable

products” and must be taxed similarly - with no more than a *de minimis* difference in tax rates; the excessive gap in tax rates between *shochu* and other spirits was inconsistent with Japan’s WTO obligations.

The reports recommended that Japan bring its tax regime into conformity with its WTO obligations. The rules in the WTO Dispute Settlement Understanding (DSU) provide that a losing party is to have a “reasonable period of time” for compliance with such a recommendation when immediate compliance is impracticable. As Japan and the United States could not mutually agree on what that compliance period should be, on December 24, 1996 the United States requested that the compliance period be determined through binding arbitration. The arbitrator’s award, issued on February 14, 1997, set the compliance period as 15 months from the date the panel reports were adopted, i.e., with a deadline of February 1, 1998.

In January 1997, the EU and Japan reached a settlement in this case. The United States continued to push for speedy compliance by Japan and for compensation for any delay. These negotiations paid off in the settlement signed on December 15.

The United States exports \$90 million in distilled spirits to Japan in an average year. Our fastest-growing product categories are high-value, signature American products such as Bourbon and Tennessee whisky, as well as vodka and rum. In the last 12 months, U.S. exports of Bourbon to Japan rose from 2.5 to 3.2 million gallons. The U.S. distilled spirits industry estimates that as a result of the WTO litigation and this settlement with Japan, excise taxes on U.S. spirits exports to Japan will be reduced nearly 60 percent, for an annual tax savings of \$94 million. The industry’s conservative estimate is that annual exports to Japan of U.S.-origin distilled spirits will increase \$20 million -- an increase of over 20 percent. Japan’s discriminatory tax and tariff structure had effectively limited foreign market share to less than eight percent.

Key Elements of Distilled Spirits Settlement

Under the terms of the settlement, Japan will make the following changes to its Liquor Tax Law:

- (1) effective May 1, 1998, the tax rate for whisky/brandy will be lowered to a rate of ¥10,225/kl, while the tax rates on *shochu* type A, liqueurs and “spirits” will be raised to the level of the current tax rate on vodka (¥9924/kl);
- (2) effective October 1, 1998, the tax rate on *shochu* B will be raised to ¥7976/kl; and
- (3) effective October 1, 2000, the tax rate on *shochu* B will be aligned with tax rates for all other types of white spirits at ¥9924/kl.

These changes are in addition to those already made by Japan on October 1, 1997. On that date Japan lowered the per-kiloliter excise tax rate on whisky/brandy by 43%, from ¥24,558/kl to

¥13,550, and increased the tax rate on the “liqueurs” category (including canned mixes) by 20% to ¥9924. Japan also increased the per-kiloliter excise tax rate on *shochu* type A by 30% to ¥8076, and raised the tax rate on *shochu* B by 48% to ¥6028.

Japan will also reduce tariffs on Bourbon and Tennessee whisky, rum, gin, vodka and liqueurs starting April 1, 1998. Tariffs on these items will go to zero on April 1, 2002.